



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
Washington, D.C. 20224

SMALL BUSINESS/SELF-EMPLOYED

June 12, 2012

Control #: SBSE-04-0612-058  
Affected IRM: 4.24.15  
Expiration Date: June 12, 2013

MEMORANDUM FOR EXCISE TAX TERRITORY MANAGERS

FROM: Holly L. McCann /s/ *Holly L. McCann*  
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SUBJECT: Enforcement of IRC 6720A *Penalty Associated with  
Certain Adulterated Fuels*

This memorandum issues guidance pertaining to the enforcement of IRC 6720A *Penalty Associated with Certain Adulterated Fuels*. Please ensure this memorandum is distributed to all affected employees.

Through IRC 6720A, the IRS enforces the EPA regulations governing the sulfur content of fuel used in diesel-powered highway vehicles and trains. The EPA regulations restrict the sulfur concentration of fuel sold for use in diesel-powered vehicles to 15 ppm or less.

In accordance with current IRM procedures, Fuel Compliance Program field employees routinely obtain samples from sellers and resellers of taxed and untaxed diesel and kerosene. If a sample is found to contain a sulfur concentration greater than 15 ppm, the employee investigates to determine who knew the fuel exceeded the allowable sulfur concentration and knowingly sold, held for sale, or distributed the fuel for use in a highway vehicle or train.

This memorandum clarifies the definition of knowledge, related to IRC 6720A, as actual knowledge and provides guidance on how to establish a taxpayer knew the sulfur content and the use of the fuel. The memorandum also provides where and when samples are obtained for sulfur testing. Samples will still be obtained for sulfur testing but the decision will be based on the facts and circumstances uncovered during the inspection. Sampling efforts will focus on terminals and specific situations where a potential adulteration issue has been identified. Situations that warrant obtaining a sample for sulfur testing will include off-color fuel, statements made by the taxpayer, or source documents.

### **Establishing Actual Knowledge of the Sulfur content and use of the Fuel**

In order to propose an IRC 6720A penalty, the IRS must establish the person transferring, reselling, holding for sale, or selling the fuel had actual knowledge that the fuel

- a. will be used in a diesel-powered vehicle or train and
- b. exceeded the applicable EPA regulations for sulfur content

Both a and b must be met.

Since the sulfur content of fuel is not visually detectable determining whether a person meets the two conditions will rest on observations (e.g. dark fuel), interviews of the taxpayer and third parties, and record analysis.

Actual knowledge of the sulfur content will usually be determined by source documents such as a delivery ticket or bill of lading informing the seller about the sulfur content of the fuel. Also, a terminal may test its fuel for sulfur content prior to distribution. Actual knowledge could also be established if the seller adulterated the fuel with a product known to the seller as possessing a concentration of sulfur greater than 15 ppm. For example, a wholesaler who fails to fully remove waste oil from the transport of before loading and distributing a load of undyed diesel to a retail location.

### Undyed Fuel

A person who includes the federal highway tax on the fuel upon sale has actual knowledge that the fuel will be used in a highway vehicle. As such, the focus of the questions, fuel screenings, and review of records will look for indicators that the fuel exceeds the maximum sulfur level.

- If there is no indication that the fuel exceeded 15 ppm then no sample should be obtained for sulfur testing only.
- If an indicator is found then a fuel sample should be obtained.
  - The investigation will focus on establishing knowledge about the sulfur content of the fuel.
  - If the lab result indicates the fuel does exceed 15 ppm and the taxpayer had actual knowledge of that fact then an IRC 6720A may be proposed.
- It may be necessary to follow the fuel up the fuel distribution stream to identify who actually knew the fuel exceeded the allowable sulfur limit.

Undyed kerosene dispensed through a blocked pump (UP registration) is the exception to the rule that sellers know the undyed fuel will be sold for use in a highway vehicle. The seller of the fuel with a UP registration knows the fuel will be sold tax free from a blocked pump. Therefore an IRC 6720A penalty will not apply to the UP registrant who does not sell the fuel for use in highway vehicles, regardless of the sulfur content of the fuel. The previous seller(s) could be subject to an IRC 6720A penalty if they also possess actual knowledge that the fuel exceeds 15 ppm sulfur. FCOs and FCAs should consider the unique facts for each case when considering whether a penalty should be assessed on a reseller

of kerosene destined for a blocked pump. For example, a wholesaler delivering kerosene into a tank at a UP registrant may know the seller dispenses the fuel from a blocked pump. Even though the wholesaler includes the federal highway tax in his price to the UP registrant, he knows the fuel will not be sold for use in a highway vehicle. Therefore, no IRC 6720A penalty should be proposed on the wholesaler.

#### Dyed Fuel

An IRC 6720A penalty will not apply to a sample of dyed, untaxed fuel with a sulfur concentration greater than 15 ppm if the fuel is not sold or held for sale for use in a highway vehicle or train. If the dyed fuel is knowingly sold or held for sale for use in a highway vehicle or train, an IRC 6720A may apply.

Since dyed fuel samples will still be obtained to determine whether the dye concentration has been altered there will be no change to when an FCO or FCA obtains a sample of dyed fuel. The concentration sample will be tested for both sulfur and dye. On the Form 9667, record the type of test as either "Concentration" or "Field Concentration."

The focus of the investigation is to determine whether the fuel was sold or held for sale for use in a highway vehicle or train.

- If there is no indication that dyed fuel was sold or held for sale for use in a highway vehicle then an IRC 6720A penalty does not apply.
- If there is an indication that the seller knowingly sold or held for sale the fuel for use in a highway vehicle then the investigation will focus on establishing knowledge about the sulfur content of the fuel and confirming actual knowledge about the use of the fuel. The knowledge regarding the use of the fuel must be actual knowledge, not presumed. For example, the absence of the dyed fuel notice on a retail pump is not actual knowledge that the fuel dispensed from the pump will be used in a highway vehicle. Treasury Regulation 48.4082-2, applies to IRC 6715, not to IRC 6720A.
  - If the lab result indicates the fuel does not exceed 15 ppm, then IRC 6720A does not apply.
  - If the lab result indicates the fuel does exceed 15 ppm then the IRC 6720A penalty will apply if the seller knew the fuel exceeded the sulfur limit **and** knew the dyed fuel was to be used in a highway vehicle. The seller, in this instance, is also subject to an IRC 6715(a)(1) penalty.

#### **Sites and Situations in which a Sample for Sulfur Testing will be obtained**

The policy has a two-fold focus;

1. terminals as the point of taxation and the narrowest point in the fuel distribution system inspected by FCOs and FCAs, and
2. downstream locations where adulteration may have occurred

As stated earlier, though samples of dyed fuel will be tested for sulfur, IRC 6720A will not be considered for dyed fuel exceeding 15 ppm unless there is actual knowledge that the fuel was sold or held for sale for use in a highway vehicle. The table below identifies when samples for sulfur testing will be obtained.

**Sites at which Samples will be obtained for Sulfur Testing**

<b>Site or Situation</b>	<b>When a Sample for Sulfur Testing will be Obtained from the Site</b>	<b>Reason for Obtaining the Sample</b>
Terminal	<ul style="list-style-type: none"> <li>• During every annual visit a sample of undyed diesel and kerosene will be obtained <b>or</b></li> <li>• If a sample of undyed fuel with a sulfur concentration greater than 15 ppm is found below the terminal rack and you are following the fuel to its source.</li> </ul> <p>Note: Dyed samples are not obtained specifically for sulfur testing but will be tested for both sulfur and dye concentration.</p>	<ul style="list-style-type: none"> <li>• Undyed diesel and kerosene leaving the terminal is taxed and therefore is for use in diesel-powered vehicles and trains.</li> </ul> <p>Note: Terminals may have sulfur test results for the fuel involved. Their records could be important when establishing actual knowledge.</p>
Wholesaler	<ul style="list-style-type: none"> <li>• If the FCO/A has reason to suspect the undyed fuel has been adulterated <b>or</b></li> <li>• If the wholesaler knowingly sold dyed diesel for use in a highway vehicle and knew the fuel exceeded 15 ppm sulfur. The knowledge can not be presumed but must be actual knowledge of its use (e.g. wholesaler fueled the highway vehicles) and its sulfur content <b>or</b></li> <li>• As directed by management</li> </ul>	<ul style="list-style-type: none"> <li>• Determine whether a product was added resulting in a sulfur concentration &gt;15 ppm. The adulterated fuel may have tax implications too.</li> <li>• Wholesaler knowingly selling dyed fuel for use in highway vehicles is subject to an IRC 6720A penalty if they also knew the fuel had &gt; 15 ppm sulfur.</li> </ul>
Retailer	<ul style="list-style-type: none"> <li>• If the FCO/A has reason to suspect the undyed fuel has been adulterated <b>or</b></li> <li>• If the retailer knowingly sold dyed diesel for use in a highway vehicle and</li> </ul>	<ul style="list-style-type: none"> <li>• Determine whether a product was added resulting in a sulfur concentration &gt;15 ppm. The adulterated fuel may have tax</li> </ul>

	<p>knew the fuel exceeded 15 ppm sulfur. The knowledge can not be presumed (i.e. lack of a dyed notice on the pump) but must be actual knowledge of its use and sulfur content <b>or</b></p> <ul style="list-style-type: none"> <li>• As directed by management</li> </ul>	<p>implications too.</p> <ul style="list-style-type: none"> <li>• Retailer knowingly selling or holding for sale dyed fuel for use in highway vehicles is subject to an IRC 6720A penalty if they also knew the fuel had &gt; 15 ppm sulfur.</li> </ul>
Management directed	<ul style="list-style-type: none"> <li>• Project (e.g. Blitz project) <b>or</b></li> <li>• Specific inspection type or site</li> </ul>	<ul style="list-style-type: none"> <li>• See specific site type above</li> </ul>

The policy shared within this memorandum will be reflected in IRM 4.24.15.

Interim Guidance Memorandum SBSE-04-0612-058 will be incorporated into IRM 4.24.15 prior to the expiration date of the memorandum.

If you have any questions, please contact Richard Little, Fuel Policy Manager.

Cc: [www.irs.gov](http://www.irs.gov)